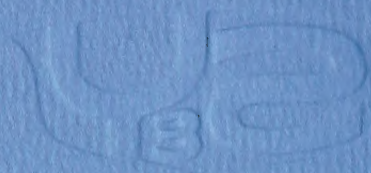


AR49



SCOTTISH and YORK
1978
Annual Report



SCOTTISH & YORK HOLDINGS LIMITED

1978

Annual Report

Board of Directors

R. D. ABBOT
R. W. BROUGHTON
S. F. CHAPMAN
K. H. DOYLE
W. G. HOLBROOK
ST. CLAIR McCABE
A. D. McEWEN
K. R. THOMSON
J. A. TORY

Officers

R. W. BROUGHTON — *Chairman of the Board and Chief Executive Officer*
W. G. HOLBROOK — *President and Chief Operating Officer*
R. D. ABBOT — *Vice-President and Secretary-Treasurer*
S. F. CHAPMAN — *Vice-President — Finance*
J. A. TORY — *Vice-President*
D. A. BOYD — *Vice-President*
N. W. McDERMOTT — *Asst. Vice-President*

Transfer Agent

MONTREAL TRUST COMPANY

Auditors

THORNE RIDDELL & CO.

Bankers

THE ROYAL BANK OF CANADA

Executive Office

155 UNIVERSITY AVENUE, TORONTO, CANADA

SCOTTISH & YORK HOLDINGS LIMITED

SCOTTISH & YORK HOLDINGS GROUP

SCOTTISH & YORK HOLDINGS LIMITED

CENTRAL CANADA
INSURANCE
SERVICE LIMITED

100%

VICTORIA INSURANCE
COMPANY OF CANADA

99.1%

SCOTTISH & YORK,
INC.

100%

SCOTTISH & YORK
INSURANCE CO.
LIMITED

97.92%

VICTORIA INSURANCE
COMPANY LIMITED

100%

SCOTTISH & YORK
INTERNATIONAL INSURANCE, INC.

80%

LINCOLN
INSURANCE
COMPANY

100%

LINCOLN
MANAGEMENT
CORPORATION

100%

ASSOCIATED
TREATY
MANAGERS, INC.

100%

GUARANTEE
INSURANCE
COMPANY

100%

INTERNATIONAL
MANAGEMENT
CORPORATION

100%

INTERNATIONAL
PREMIUM
COMPANY

100%

To The Shareholders

On behalf of the Board of Directors, I am pleased to present the consolidated financial statements of Scottish & York Holdings Limited for the year ended December 31st, 1978. As will be seen from the graphs and table in this report, 1978 was a year of excellent progress for your Company.

Net Income for the year was \$10,551,440, or \$1.32 per common share compared with \$6,252,237 or 78.2¢ per common share in 1977. Gross premiums written increased to \$125,037,555 from \$116,094,454 while net premiums written rose to \$60,043,358 from \$58,638,786. Underwriting profit amounted to \$7,024,685 up from \$6,312,380 in 1977. Investment income increased substantially to \$9,131,089 up from \$5,050,137 a year earlier.

The Company continued to expand its operations in the U.S. with a fourth regional office being opened in Atlanta, Georgia in April of 1978. During the year, Guarantee Insurance Company obtained 8 additional state licenses increasing the number of states in which it is now admitted to 40 while Lincoln Insurance Company obtained 5 more approvals for a total of 46 states in which it is now qualified.

During the year, the jurisdiction of incorporation of Guarantee Insurance Company was moved from Texas to Delaware. This move was precipitated by the heavy retaliatory premium tax imposed by some states on Texas-based companies. At the time of our acquisition of Guarantee Insurance in 1975, this was not significant. However, with the broadened licensing and subsequent increase in premium writings in other states, it was apparent a move should be made. It is estimated we will save approximately \$400,000 in premium tax in the first year with little, if any, disruption in this company's operations.

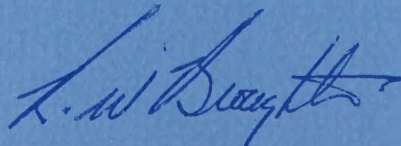
Despite the introduction of new product lines in Canada, the gross premium volume was down approximately 1.5 million dollars from the previous year. This was due to the extremely competitive market situation as well as the partial loss of the automobile portfolio in the Province of Quebec through government involvement. Nevertheless, our market penetration was substantially increased and an improved underwriting profit generated.

Two dividend increases were approved by the Directors of your Company during the year in light of the improved earnings. The annualized dividend rate is now 24¢ per share versus a total of 15¢ paid in 1977. In considering our dividend payout, it should be kept in mind that it is the Company's policy to finance growth as much as possible from retained earnings, while maintaining a reasonable return for shareholders on their investment. Growth of your Company will require a continued buildup of surplus to support future increases in premium writings and we will continue to strive for a balance between growth and dividends.

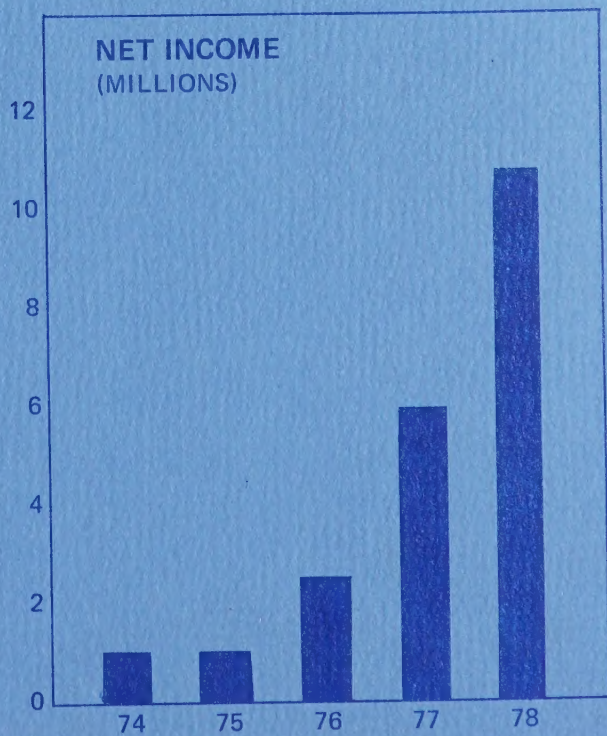
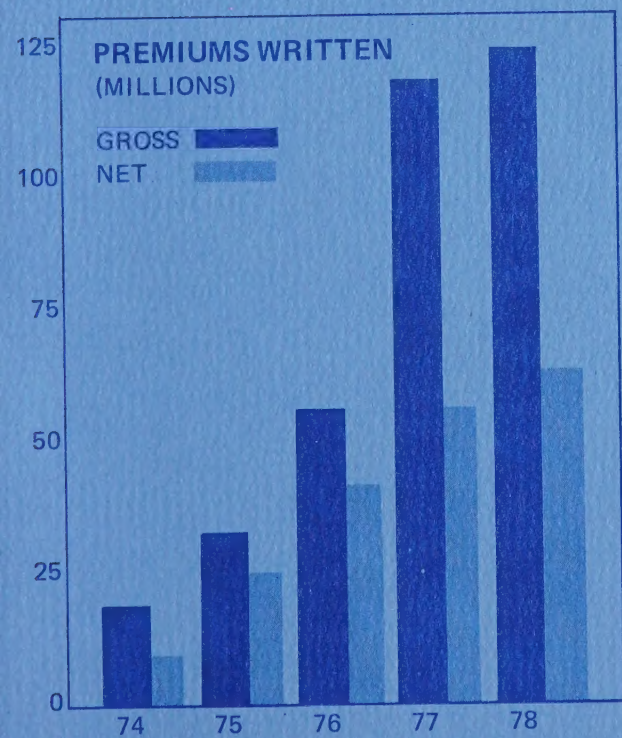
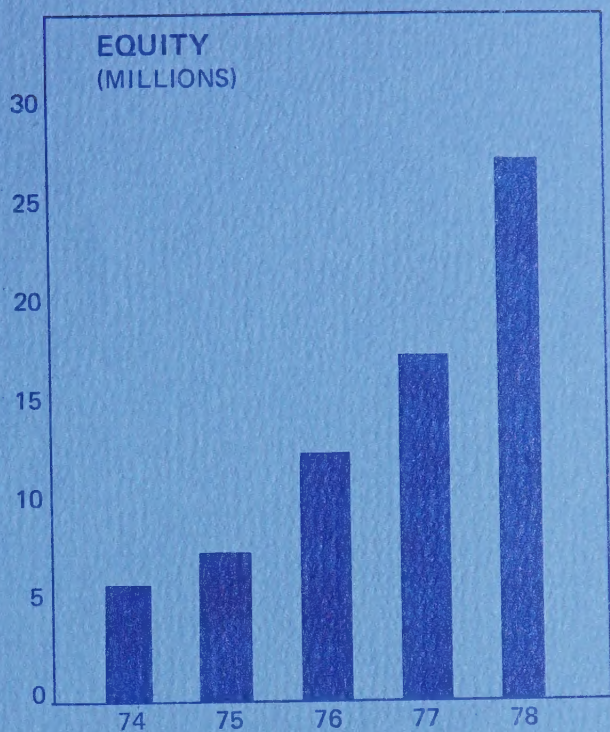
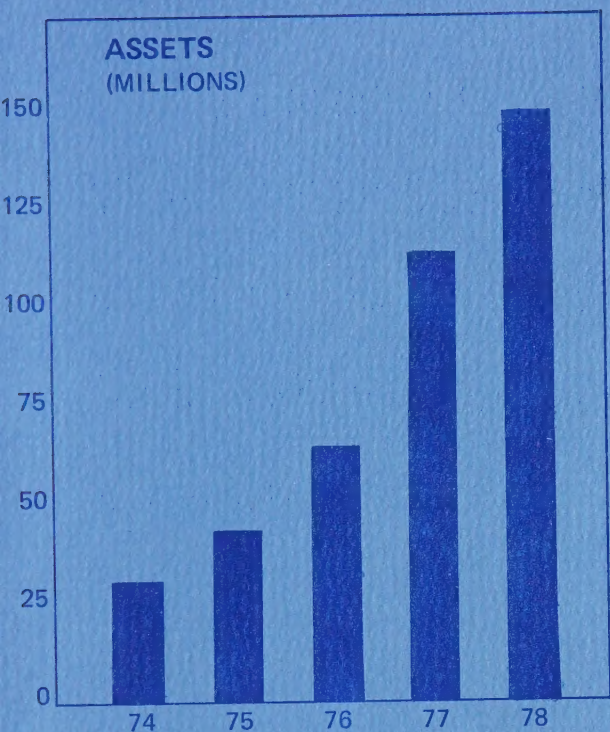
As we have stated in the past, the insurance industry is cyclical and it would appear we are in a down cycle at the present time. The soft market conditions we are experiencing in North America will continue into 1979 with the resultant erosion of underwriting profit. I am confident that through the determination of our staff and diversification of our product lines we will be equal to the challenge and continue to outperform the industry.

On behalf of the Board of Directors, I would like to express our sincere appreciation to management and staff for their dedication and efforts during the past year.

For the Board of Directors



R. W. BROUGHTON
Chairman of the Board and
Chief Executive Officer.



SCOTTISH & YORK HOLDINGS LIMITED (Incorporated under the laws of Scotland)
CONSOLIDATED BALANCE SHEET DECEMBER 31, 1978

ASSETS		
	<u>1978</u>	<u>1977</u>
Cash	\$ 2,331,663	\$ 2,668,635
Marketable securities (note 2)		
Term deposits	22,459,524	22,172,268
Bonds (market value 1978, \$80,969,123; 1977, \$54,535,759)	85,093,514	55,745,866
Stocks (market value 1978, \$9,114,260; 1977, \$7,160,626)	10,423,428	7,824,814
Accrued interest on bonds and term deposits ...	1,641,209	860,722
Accounts receivable	29,531,744	20,781,656
Furniture, fixtures and automobiles less accumulated depreciation 1978, \$209,510; 1977, \$132,640	579,608	253,726
Premium paid on acquisition of shares of subsidiary companies, net of amortization of \$185,733 (1977, \$69,230)	1,302,592	1,006,513
	<u>\$153,363,282</u>	<u>\$111,314,200</u>

Approved by the Board

W. G. HOLBROOK, Director

R. D. ABBOT, Director

ntario) **AND SUBSIDIARY COMPANIES**

LIABILITIES

	<u>1978</u>	<u>1977</u>
Notes payable (note 3)	\$ 11,115,192	\$ 4,036,147
Accounts payable and accrued liabilities	31,883,391	22,359,594
Customers' deposits	26,250	26,250
Provision for outstanding claims	55,641,631	40,059,749
Income and premium taxes payable	2,721,184	4,301,614
Deferred revenue	21,375,408	19,653,637
Interest of minority common shareholders of subsidiary companies	2,800,372	2,008,795
	<u>125,563,428</u>	<u>92,445,786</u>

SHAREHOLDERS' EQUITY

Capital stock		
Authorized		
10,000 First preference shares, par value \$50 each, issuable in series		
12,000,000 Common shares without par value		
Issued		
8,000,000 Common shares	3,701,000	3,701,000
Retained earnings	24,098,854	15,167,414
	<u>27,799,854</u>	<u>18,868,414</u>
	<u>\$153,363,282</u>	<u>\$111,314,200</u>
Contingent liabilities and contractual commitments (note 4)		

SCOTTISH & YORK HOLDINGS LIMITED
and subsidiary companies

CONSOLIDATED STATEMENT OF INCOME
YEAR ENDED DECEMBER 31, 1978

	<u>1978</u>	<u>1977</u>
Gross premiums written and other income	\$134,169,071	\$121,144,591
Underwriting profit.	7,024,685	6,312,380
Investment income	9,131,089	5,050,137
	<u>16,155,774</u>	<u>11,362,517</u>
Interest on notes payable	470,808	156,874
Income before undernoted items.	15,684,966	11,205,643
Income taxes.	4,360,653	4,179,277
Income before minority interest	11,324,313	7,026,366
Interest of minority common shareholders of subsidiary companies.	772,873	774,129
Net income	<u>\$ 10,551,440</u>	<u>\$ 6,252,237</u>
Earnings per share	\$1.32	\$.78

CONSOLIDATED STATEMENT OF RETAINED EARNINGS
YEAR ENDED DECEMBER 31, 1978

	<u>1978</u>	<u>1977</u>
Balance at beginning of year	\$ 15,167,414	\$ 9,775,177
Net income	10,551,440	6,252,237
	<u>25,718,854</u>	<u>16,027,414</u>
Dividends on common shares	1,620,000	860,000
Balance at end of year	<u>\$ 24,098,854</u>	<u>\$ 15,167,414</u>

SCOTTISH & YORK HOLDINGS LIMITED
and subsidiary companies

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
YEAR ENDED DECEMBER 31, 1978

	1978	1977
Resources provided		
Operations (as outlined below)	\$28,846,046	\$28,338,773
Decrease in term deposits		2,503,815
Net change in other assets and liabilities	(1,580,430)	1,966,771
Proceeds from notes payable	7,557,192	3,334,090
Decrease in cash	336,972	
	<u>\$35,159,780</u>	<u>\$36,143,449</u>
Resources applied		
Purchase of marketable securities, net		
Bonds	\$29,347,648	\$29,054,406
Stocks	2,598,614	2,461,931
Increase in term deposits	287,256	
Notes payable	478,147	1,191,751
Purchase of furniture, fixtures and automobiles, net	415,533	150,590
Increase in premium paid on acquisition of shares of subsidiary companies (note 1 (a))	412,582	509,873
Dividends on common shares	1,620,000	860,000
Increase in cash		1,914,898
	<u>\$35,159,780</u>	<u>\$36,143,449</u>
Operations		
Net income	\$10,551,440	\$ 6,252,237
Items not involving cash		
Depreciation	89,651	35,340
Amortization of premium paid on acquisition of shares of subsidiary companies (note 1 (e))	116,503	45,902
Interest of minority common shareholders of subsidiary companies	791,577	739,587
Increase in deferred revenue	1,721,771	6,303,213
Increase in provision for outstanding claims	15,581,882	15,729,880
Increase in accounts payable and accrued liabilities	9,523,797	14,959,848
Write off of agencies, agreements and contracts		110,116
Increase in accounts receivable and accrued interest	(9,530,575)	(15,837,350)
Resources provided from operations	<u>\$28,846,046</u>	<u>\$28,338,773</u>

SCOTTISH & YORK HOLDINGS LIMITED

and subsidiary companies

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 1978

1. ACCOUNTING POLICIES

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles which, as to the subsidiary insurance companies, differ in some respects from statutory accounting practices followed in the preparation of financial statements submitted to regulatory authorities.

(a) Principles of Consolidation

The consolidated financial statements include all the subsidiary companies, which are:

	Percentage ownership
Canadian Group	
Scottish & York Insurance Co. Limited	97.92%
Central Canada Insurance Service Limited	100%
Victoria Insurance Company of Canada	99.1%
U.S. Group	
Scottish & York, Inc.	100%
Lincoln Insurance Company	80%
Lincoln Management Corp.	80%
Associated Treaty Managers, Inc.	80%
Guarantee Insurance Company	80%
International Management Corporation	80%
Scottish & York International Insurance, Inc.	80%
International Premium Company	80%
Bahamas	
Victoria Insurance Company Limited	100%

Under an agreement dated June 27, 1975, among Scottish & York Holdings Limited, International Insurance Holdings Corporation, Scottish & York, Inc. and Scottish & York International Insurance, Inc. relating to the July 1, 1975 acquisition of the 80% interest in the U.S. Group, provision is made whereby additional consideration may be payable depending on the level of future profits of the U.S. Group. The purchase agreement also provides for adjustments in respect of uncollected accounts receivable, undisclosed liabilities and unreflected assets at that date.

As a result of the application of these covenants of the purchase agreement a provision for additional purchase consideration amounting to \$412,582 for the current year and \$922,455 from inception of the agreement has been paid or accrued in the accounts.

(b) Translation into Canadian Dollars

The accounts of the subsidiary companies in the United States and the Bahamas have been translated into Canadian dollars on the following basis:

- (i) assets and liabilities of a monetary nature at the rate of exchange prevailing at December 31,
 - (ii) all other assets and liabilities at the rate of exchange prevailing at the date the assets were acquired or the liabilities incurred,
 - (iii) income and expenses at the average rate for the year.
- (c) **Marketable Securities**
 - (i) Term deposits are recorded at cost.
 - (ii) Bonds are recorded at cost or amortized cost.
Interest income is recorded on an accrual basis.
 - (iii) Stocks are recorded at cost.
Dividend income is recorded on a cash received basis.
 - (iv) Gains and losses on disposal of investments are determined on a first in, first out basis.
- (d) **Furniture, Fixtures and Automobiles and Accumulated Depreciation**
All furniture, fixtures and automobiles are recorded at cost, less accumulated depreciation. Furniture, fixtures and equipment are depreciated over their estimated useful life at varying rates ranging from 12½% straight line basis to 20% reducing balance basis. Automobiles are depreciated over their useful life at the rate of 30% reducing balance basis.
- (e) **Premium Paid on Acquisition of Shares of U.S. Subsidiary Companies**
The company amortizes such premium over forty years from date of acquisition.
- (f) **Deferred Revenue**
 - (i) **Deferred commission income and policy acquisition costs.**
Policy acquisition costs, net of reinsurance allowances, are deferred and amortized over the terms of the related policies. For the years 1978 and 1977 deferred commission income exceeded deferred acquisition costs. Accordingly, the net credit balance is included in deferred revenue.
 - (ii) **Deferred premium income.**
Premium income is deferred until it is earned. The basis for taking premiums into income is in accord with policies prescribed by the regulating organizations under which the companies operate.
- (g) **Provision for Outstanding Claims**
The liabilities for losses and claims and related adjustment expenses are determined using case basis evaluations plus a provision for unreported claims and represent estimates of the ultimate net cost of all losses and claims incurred through December 31, 1978. Since the provisions are necessarily based on estimates of future trends in claim severity and frequency and other factors, which could vary as the losses are settled, the ultimate liability may be more or less than the estimated amounts. These liabilities have been stated net of reinsurance recoverable from other companies. Although it is not possible to measure the degree of variability inherent in such estimates, management believes that the liabilities for losses and related adjustment expenses are adequate. The estimates are continually reviewed and, as adjustments to these liabilities become necessary, they are reflected in current operations.
- (h) **Recognition of Income**
A subsidiary company, Associated Treaty Managers, Inc., manages a number of reinsurance arrangements for which it receives management fees based upon earned premiums. The fee income is recognized simultaneously with the recognition of earned premiums by the reinsurers.

2. MARKETABLE SECURITIES

Marketable securities having a cost of approximately U.S. \$9,300,000 at December 31, 1978 were deposited to secure liabilities from participation in reinsurance pools and reinsurance ceded contracts.

3. NOTES PAYABLE	<u>Total</u>	<u>Due within one year</u>
Note payable to bank bearing interest at 11 5/8%, due December 31, 1980 (\$5,000,000 U.S.)	\$ 5,930,000	
Note payable to bank bearing interest at the rate of U.S. prime plus 1 1/2% (\$3,000,000 U.S.)	3,558,000	\$ 296,500
Demand note payable to bank bearing interest at the rate of U.S. prime plus 1% (\$622,000 U.S.)	737,692	737,692
Demand note payable to bank bearing interest at 12% (\$750,000 U.S.)	889,500	889,500
	<u>\$11,115,192</u>	<u>\$1,923,692</u>
Principal due in each of the next five years:		
1979	\$ 1,923,692	(\$1,622,000 U.S.)
1980	6,523,000	(5,500,000 U.S.)
1981	889,500	(750,000 U.S.)
1982	889,500	(750,000 U.S.)
1983	889,500	(750,000 U.S.)
	<u>\$11,115,192</u>	<u>(\$9,372,000 U.S.)</u>

4. CONTINGENT LIABILITIES AND CONTRACTUAL COMMITMENTS

- (a) A wholly owned subsidiary company Victoria Insurance Company Limited, has been assessed Federal income taxes relating to the years 1968, 1969, and 1970 amounting to approximately \$1,000,000 including interest to November 30, 1973. A Notice of Objection was filed with respect to these assessments in 1974 and Revenue Canada, Taxation reconfirmed the assessments on February 6, 1975.

The company received a favourable judgement on an appeal to the Tax Review Board on September 7, 1977 but has received notification from Revenue Canada, Taxation of its intention to appeal the decision to the Federal Court of Canada. No date for a hearing of this second appeal has been set.

The company has deposited its share investment in subsidiary companies Scottish & York Insurance Co. Limited and Victoria Insurance Company of Canada with The Royal Bank of Canada to be held as security until the outcome of this appeal is known.

- (b) The company leases office space for a term expiring in 1984 with an option to extend this to 1994. The annual rental is approximately \$134,000.

5. ANTI-INFLATION LEGISLATION

The company and its Canadian subsidiaries were subject to the provisions of the Federal Government's Anti-Inflation Act until its termination on December 31, 1978. This Act imposed restrictions on prices, profit margins, compensation to employees and payment of dividends by the parent company.

In the opinion of management, the company and its Canadian subsidiaries have complied with the provisions of the Act.

6. OTHER STATUTORY INFORMATION

	<u>1978</u>	<u>1977</u>
Direct remuneration of directors and senior officers (as defined by The Business Corporations Act)	\$289,968	\$266,500
Depreciation	\$ 89,651	\$ 35,340
Amortization	\$116,503	\$ 45,902

Auditors' Report

To the Shareholders of
Scottish & York Holdings Limited

We have examined the consolidated balance sheet of Scottish & York Holdings Limited as at December 31, 1978 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. For those subsidiaries of which we are not the auditors, we have carried out such enquiries and examinations as we considered necessary in order to rely on the reports of the other auditors for purposes of consolidation.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Toronto, Canada
March 15, 1979

THORNE RIDDELL & CO.,
Chartered Accountants

SCOTTISH & YORK HOLDINGS GROUP

Five Year Performance Record

YEAR	GROSS PREMIUMS WRITTEN	NET PREMIUMS WRITTEN	DEFERRED REVENUE	INCOME BEFORE TAXES AND MINORITY INTEREST	INCOME TAXES	NET INCOME	EARNINGS PER SHARE	DIVIDENDS PAID PER SHARE
1978	125,037,555	60,043,358	21,375,408	15,684,966	4,360,653	10,551,440	\$1.32	20.25¢
1977	116,094,454	58,638,786	19,653,637	11,205,643	4,179,277	6,252,237	78.2¢	10.75¢
1976	56,052,394	41,540,610	13,350,424	4,430,320	1,772,550	2,489,230	31.1¢	3.5¢
1975	31,676,100	24,373,390	10,256,951	1,244,773	377,293	910,286	15.2¢	—
1974	19,975,895	13,812,615	4,837,483	1,256,719	429,534	827,185	13.8¢	13.5¢

Monday

11 a.m.

AR49



SCOTTISH
&
YORK

INTERIM
REPORT

JUNE 30, 1978

SCOTTISH & YORK HOLDINGS LIMITED
and Subsidiary Companies
CONSOLIDATED STATEMENT OF INCOME

TO THE SHAREHOLDERS

Net income for the six month period ending June 30, 1978 was \$5,763,256 or 72¢ per common share compared to \$2,312,768 or 29¢ per common share for the same period last year.

All operations for the first half of 1978 have shown significant gains over the corresponding period of last year. Premium volume continues to grow, particularly in the United States reflecting the broader licenses and approvals secured in the past two years. In keeping with our expansion in the United States, our fourth regional office located in Atlanta, Georgia was just recently opened to service the south eastern states.

Rate competition remains strong in Canada and is also being felt to a lesser extent in the United States. This will make it increasingly difficult to maintain the same margin of underwriting profit we enjoyed last year, nevertheless the outlook for the balance of the year remains favourable.

R. W. BROUGHTON
Chairman of the Board and
Chief Executive Officer

August 25th, 1978

	<u>Six Months Ended</u>	
	<u>June 30, 1978</u>	<u>June 30, 1977</u>
Gross Premium Written and Other Income	\$65,741,512	\$47,414,230
Underwriting Profit	5,447,976	1,711,322
Investment Income	4,080,314	2,198,101
	9,528,290	3,909,423
Interest on Notes Payable	209,969	29,925
	9,318,321	3,879,498
Income Taxes	3,061,302	1,188,343
	6,257,019	2,691,155
Interest of Minority Common Shareholders of Subsidiary Companies	493,763	378,387
Net Income	<u>\$ 5,763,256</u>	<u>\$2,312,768</u>
Net Income per Share	72¢	29¢

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	<u>Six Months Ended</u>	
	<u>June 30, 1978</u>	<u>June 30, 1977</u>
Resources Provided		
Operations:		
Net Income for the Six Months	\$5,763,256	\$2,312,768
Add Items not Involving a Current Outlay of Funds		
Depreciation	24,900	17,000
Interest of Minority Common Shareholders of Subsidiary Companies	493,763	378,387
	6,281,919	2,708,155
Increase in Accounts Payable	4,008,356	4,392,417
Increase in Provision for Outstanding Claims	6,953,154	5,614,065
Increase in Deferred Revenue	1,899,783	5,827,742
Decrease in Cash	1,016,933	—
Increase in Notes Payable	96,162	—
	<u>\$20,256,307</u>	<u>\$18,542,379</u>
Resources Applied		
Increase in Cash	\$ —	\$2,185,774
Purchase of Marketable Securities, Net	7,777,567	9,722,444
Increase in Accounts Receivable	9,912,300	4,982,188
Decrease in Notes Payable	—	675,808
Decrease in Taxes Payable	1,413,872	—
Dividends on Common Shares	660,000	320,000
Net Change in Other Assets and Liabilities	492,568	656,165
	<u>\$20,256,307</u>	<u>\$18,542,379</u>